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SIPDIS

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TAGS: EFIN ECON TU
SUBJECT: Problems with Banking Law Negotiations

REF: ANKARA 5998

This is a joint cable with Congen Istanbul.

¶1. (Sbu) Summary: Despite months of extensive consultation with bankers, and an explicit-but now postponed-IMF deadline, a new banking law drafted by Turkish regulators is considered far too restrictive by both bankers and the IMF. Bank regulators and the GOT are working to revise the text, but the latest set of proposals from the regulators remains unacceptable to the IMF and World Bank. Setbacks in the negotiations could well require an additional IMF-World Bank mission in mid-November. End Summary.

Background:

¶2. (Sbu) At the beginning of 2004, when the IMF staff and the GOT set the structural reform agenda for the year, it was agreed that Turkey needed a completely revised banking law. For months the banker's association and its membership gave input and bank regulators looked at other countries practices on issues such as banning bank owners from also owning news media, industrial groups, pension funds, or being connected with political parties. The introduction of bans on any of these cross-holdings would have been highly disruptive to some of Turkey's largest banks, most of whose ownership structures violate at least one of these restrictions. In the end, tightening cross-holding requirements were dropped as too restrictive and, according to Bank Regulatory and Supervisory Agency (BRSA) Chairman Tevfik Bilgin, as not comparable to rules in other OECD countries.

¶3. (Sbu) After postponement of a June 30 IMF deadline, a draft written by BRSA staff was completed in August. In recent weeks, however, press reports and post contacts have made clear that it is unacceptable to the bankers association, which has successfully lobbied the IMF to take up many of its issues. Because of the controversy and the press of other business, including the 2005 budget, Deputy Prime Minister Sener indicated last week that parliament will only take up the banking issue in the new year.

Bankers Critical:

¶4. (Sbu) In a series of recent press interviews and statements, Turkey's leading bankers, led by Bankers' Association Chairman and Disbank CEO Ersin Ozince, have strongly criticized the draft law as far too intrusive into bankers' actions. Ozince noted that over-regulation could cause the sector to cease functioning. He attacked a provision that would require banks to sell their non-bank assets and argued that banks needed to be profitable for the sector to be strong. Ozince called for modifications in the banking law to be limited to measures necessary for EU compliance.

5.(Sbu) In a recent meeting with Istanbul econoff, Bankers Association Secretary General Ekrem Keskin elaborated on bankers' concerns. In the association's view, the new law's provisions penalize entrepreneurship and risk-taking and are not well adapted to Turkish conditions. As both Keskin and the head of one leading international bank in Turkey told us, the draft is too punitive. In the latter's view, it is based on the belief that if Turkey had "imprisoned bank owners" before 2001, it could have avoided that year's banking crisis. As a result, it makes no distinction between bank losses caused by macroeconomic conditions and those resulting from "bad faith." In addition, in a revealing lack of faith in Turkey's regulators, the act spells out in extraordinary detail the responsibilities of the BRSA, essentially transferring regulatory power from that organization to the parliament, and in the association's view turning the board itself into an audit and inspection agency. An added complication is the continuing struggle for authority over the sector between the recently separated BRSA and Savings Deposit Insurance Fund (SDIF). The latter hopes to retain a role in banking

supervision, and it and the Banking Board continue to argue over who should set premium levels for deposit insurance. More generally, Keskin noted that Turkish banking law has been modified a number of times in recent years, and already is "85 percent" compatible with EU standards. The constant changes create a climate of uncertainty that inhibit the sector.

¶6. (SBU) The association criticized the draft law's excessive capital adequacy requirements, overly strict limits on bank's non-financial participations, and an "unworkable" requirement that each bank board have two "independent" members with added authority. The latter provision, in particular, is difficult for banks to implement, in Keskin's view, and he suggested it may be a way for the Turkish government to give its supporters a larger role in the financial sector. Bankers also worry that the law will make it harder for Turkish banks to meet the Basle-II capital adequacy requirements.

¶7. (Sbu) Ergun Okur, Executive Vice President of Oyak Group and a board member of Oyak Bank, told econoffs no one could do banking with the law as drafted. Another prominent banker added that the draft law would likely fail in its goal of preventing a repeat of past problems in the sector, for while it would likely cause good capital and management to leave the sector: "daring people would stay."

IMF Staff Sides with Banks:

8.(Sbu) The IMF Resrep told econoffs that IMF banking experts, after a closer look at the text, were sympathetic to the concerns raised by bankers. (Keskin noted that after the IMF's initial clearance of the text, the association had a full-day meeting with the fund to lay out its concerns.) The Resrep said the Central Bank also had concerns that the law as drafted impinged on its ability to conduct monetary policy, by specifying circumstances under which the Central Bank would be required to provide liquidity to banks. The IMF objected to the draft law not taking into account the findings of the commission of inquiry on the Imar Bank collapse. Specifically, the commission and other observers had cited the sworn bank auditors' monopoly of bank inspections as overly restrictive in terms of the expertise that could be brought to bear. On the other hand, the BRSA Vice President in charge of on-site inspection (sworn auditors), Mustafa Korhan, told econoffs that the sworn bank auditors support allowing information technology experts to join in on-site inspections, in the interest of avoiding another Imar Bank-like case.

¶9. (Sbu) The Resrep confirmed that the draft would set capital requirements above EU standards-an unnecessarily onerous requirement at a time when banks are slowly rebuilding their capital from the effects of the 2001 crisis. The law would also mandate regular ratings by rating agencies-an unnecessary cost in the view of both bankers and the IMF. The law would force banks to finance a training center for bankers, and includes a provision granting State-owned banks the same seniority in debt workouts currently enjoyed by the deposit insurance agency, the SDIF. The latter provision seems inconsistent with the IFI-mandated state bank privatization strategy. Both bankers and the IMF objected to a provision that would weaken bankers' rights in workouts, by making an arbitral body's decisions binding only on the banks rather than on debtors as well. Finally, the IMF objected to retention of a loophole on connected lending.

Unexpected BRSA Proposal Stops Progress:

¶11. (Sbu) Though the IMF Deputy Resrep told econoff last week that Fund staff were encouraged by a newly-agreed negotiating process that would allow the GOT to take over the process-albeit with continued BRSA involvement-in an October 20 meeting, a World Bank banking expert told econoffs the whole process has been stopped by the latest BRSA draft. He said the latest draft included the proposal that the bankers association would take over management of deposit insurance. Aside from the conflict of interest problem, he pointed out the association had no experience with this role. Worse, the World Bank expert said SDIF officials with whom he spoke had no prior knowledge of BRSA's proposal to take away one of SDIF's core functions.

¶12. (Sbu) The World Bank official said IMF Mission Chief Moghadam forcefully rejected the new draft, and went over BRSA Chairman Bilgin's head to seek-and later obtain-Minister Babacan's agreement to go back to negotiating on the basis of the August draft. The World Bank official said this latest development meant the IMF and World Bank banking law experts would return in two weeks and that negotiations over a new Standby would have to be further delayed.

¶13. (Sbu) Even if a new draft can be worked out with the IMF and World Bank, it would still have to be approved by the Council of Ministers before the World Bank's condition under

its PFPSAL3 loan facility would be met. For this reason the World Bank official doubted the second tranche of this facility would go to the bank board before January or February.

Comment and Conclusion:

¶14. (Sbu) The group of current and former sworn bank auditors-led by BRSA President Bilgin-have a reputation as a tight-knit cadre with a tendency to distrust outsiders, especially bankers. It seems they got carried away in drafting the new banking law. Bilgin's proposal-from out of left field-for the bankers association to take over deposit insurance demonstrates poor judgment but also points to serious problems between BRSA and SDIF.